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Cynthia K. Cox
Executive Director-
Federal and State Relations

Suite 900
1133-21st Street, N.W.
Washington, D.C. 20036-3351
202 463-4104
Fax: 202 463-4196

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Federal Communications Commission
Office of Secretary

October 7, 1996

Ex Parte

Mr. William F. Caton
Acting Secretary
1919 M Street, NW
Federal Communications Commission
Washington, D.C. 20554

RE: Ex Parte CC Docket No 96-45, Federal-State Joint Board on Universal Service

Dear Mr. Caton:

On October 7, E. Bush, P. Martin and the undersigned representing BellSouth met with Commissioner Kenneth McClure, member of the Federal-State Joint Board and Commissioner with the Missouri Public Service Commission to discuss BellSouth's position regarding the above-referenced proceeding. The attached documents represent the basis for the presentation and discussion and are consistent with BellSouth's filings in this proceeding. A copy of the attached documents were also provided to Martha Hogarty, member of the Federal-State Joint Board.

Two (2) copies of this notice and the attached documents are being filed with the Secretary of the FCC, pursuant to Sections 1.1206(a)(1) and 1.1206(a)(2) of the Commission's rules.

Sincerely,

Cynthia K. Cox

Cynthia K. Cox

Attachments

cc: Commissioner McClure (w/o attachments)
Martha Hogarty (w/o attachments)

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List A B C D E

Illustrative Example of Fund Calculations

	($ B)	($ B)
Total Federal (Joint Board) Fund		15
Interstate Component	7	
Intrastate Component	8	
Total State Funds		6
Total Core Universal Service Support		21
Total Estimated Interstate Retail Revenues	65	
Interstate Assessment %	10.8%	
Total Estimated Intrastate Retail Revenues	95	
Average Intrastate Assessment % (Federal)	8.4%	
Average Intrastate Assessment % (State)	6.3%	
Average Intrastate Assessment % (Total)	14.7%	

Illustrative Example of Support Calculations for a Typical LEC

LEC A:	($ M)
Gross Interstate Support:	120
Gross Intrastate Support:	250

End-User Surcharge Approach

* All assessments collected from the end-user
* Rate reductions equal gross support
  For LEC A, Interstate reductions equal $120M;
  Intrastate reductions equal $250M

Company Assessment Approach

* Companies assessed based on their share of assessable revenues
* Rate reductions equal net support
  Example: LEC A is assessed $18M for Interstate, and
  $200M for Intrastate
  LEC A makes Interstate Reductions of $102M ($120M-$18M)
  LEC A makes Intrastate Reductions of $50M ($250M-$200M)

Net Result:
LEC A must retain $18M in support within its Interstate rates
LEC A must retain $200M in support within its Intrastate rates

Recommendations on Universal Service Funding

October, 1996

BellSouth Telecommunications, Inc.

Need to Make Implicit Support Explicit

- Telecommunications Act of 1996 requires that universal service support be explicit, sufficient, and sustainable
- Most support today is implicit, and will not be sustainable in a competitive environment
- Need to replace current federal universal service support mechanisms with explicit, sufficient and sustainable mechanism
- A principle of the Telecommunications Act is that there shall be both state and federal mechanisms

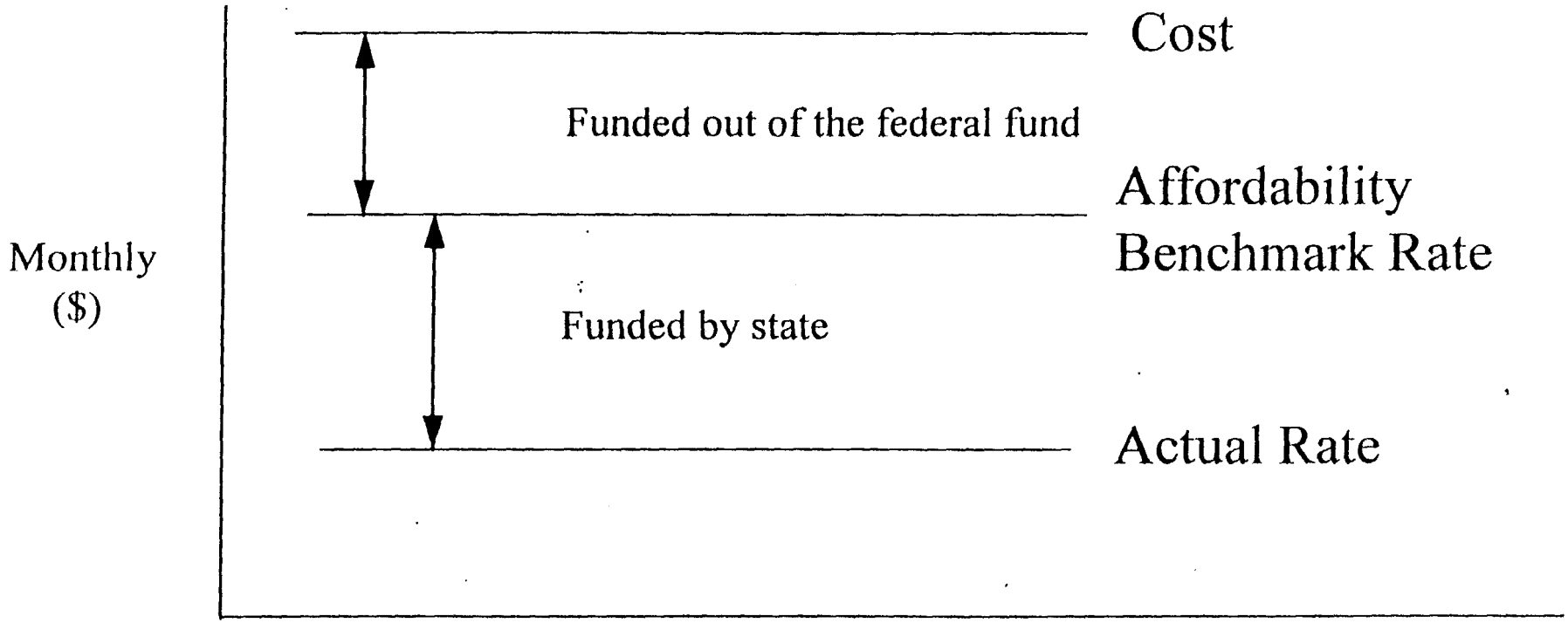
Key Requirements of any New Funding Mechanism

- Should not shift burden for funding universal service between jurisdictions
- Should generally be revenue neutral upon implementation
- Purpose should be to replace current implicit support with explicit support

Avoid Jurisdictional Shifts

- The universal service burden can be shifted from the FCC to the states in a number of ways
  - » FCC establishes a bijurisdictional federal universal service fund, but then limits the size of the federal fund
    - – overly low proxy cost estimates used
    - – overly high affordability benchmarks used
  - » Separations reform takes place and cost recovery is shifted to the states

Example A



Example A:

In this scenario, funding is provided out of the federal universal service fund for the difference between the cost and the affordability benchmark rate. The state is responsible for funding the difference between the affordability benchmark rate and the actual rate. It could accomplish this by establishing an intrastate universal service fund.

Benefits of a Sufficient Universal Service Fund

- *Consumers* benefit because rates remain affordable and companies have an incentive to invest in universal service
- *Facilities based competitors* benefit because the support, which is portable, makes it economic to enter even high cost areas
- *Regulators* benefit because they will have met their legal mandate to ensure support is explicit and sufficient

Universal Service Funding

- Three major components of Interstate fund
  - » Core Fund
  - » Education and Health Care
  - » Low Income

Core Universal Services

- Definition includes voice grade basic local exchange telephone service
  - » Single Party Service with Directory Listing
  - » Touch Tone
  - » Access to Emergency Services
  - » Access to Operator Services
  - » Access to Directory Services
- Total Support calculated on an unseparated basis
- Distinct split made between Interstate and Intrastate components
- Interstate support initially set equal to Interstate CCL, DEM Weighting, Long-Term Support and explicit support from current USF Fund

Calculation of Universal Service Support

Step 1: Determine affordability benchmarks

Step 2: Calculate universal service cost per line for small areas

Step 3: Calculate Federal and state support

Step 4: Calculate total support for each company

Step 5: Make rate reductions to remove implicit support and offset initial level of explicit support

Affordability Benchmarks

- Affordability benchmarks should be set based on 1% of county median income
- Floors and ceilings for affordability benchmarks should also be established
- The affordability benchmark acts as a demarcation point between the federal fund and the state fund
- Local rates need not rise to the affordability benchmark; however, state is responsible for funding any shortfall

Universal Service Costing

- Universal service support should be based on fully distributed actual costs
  - » Loop and local switching costs should be included
  - » Share of overhead costs should be included
- Portability of subsidy ensures efficient provision of service
- No proxy model can truly replicate actual costs

Eligibility for Core Universal Service Support

- Carriers must meet certain criteria to be designated as "eligible" for support
  - » offer universal service on a standalone basis throughout a defined serving area
  - » advertise the availability of service throughout serving area using general distribution media
  - » subject to service provisioning rules
  - » the carrier may use its own facilities or a combination of its own facilities and resale
- Support to be provided on a "per line served" basis to any eligible carrier

Contributions to the Fund

- All telecommunications services providers should contribute
- Contributions should be based on end-user revenues
- An end-user surcharge is the most efficient way to collect the assessment
- Companies must have a competitively neutral way to recoup their assessments

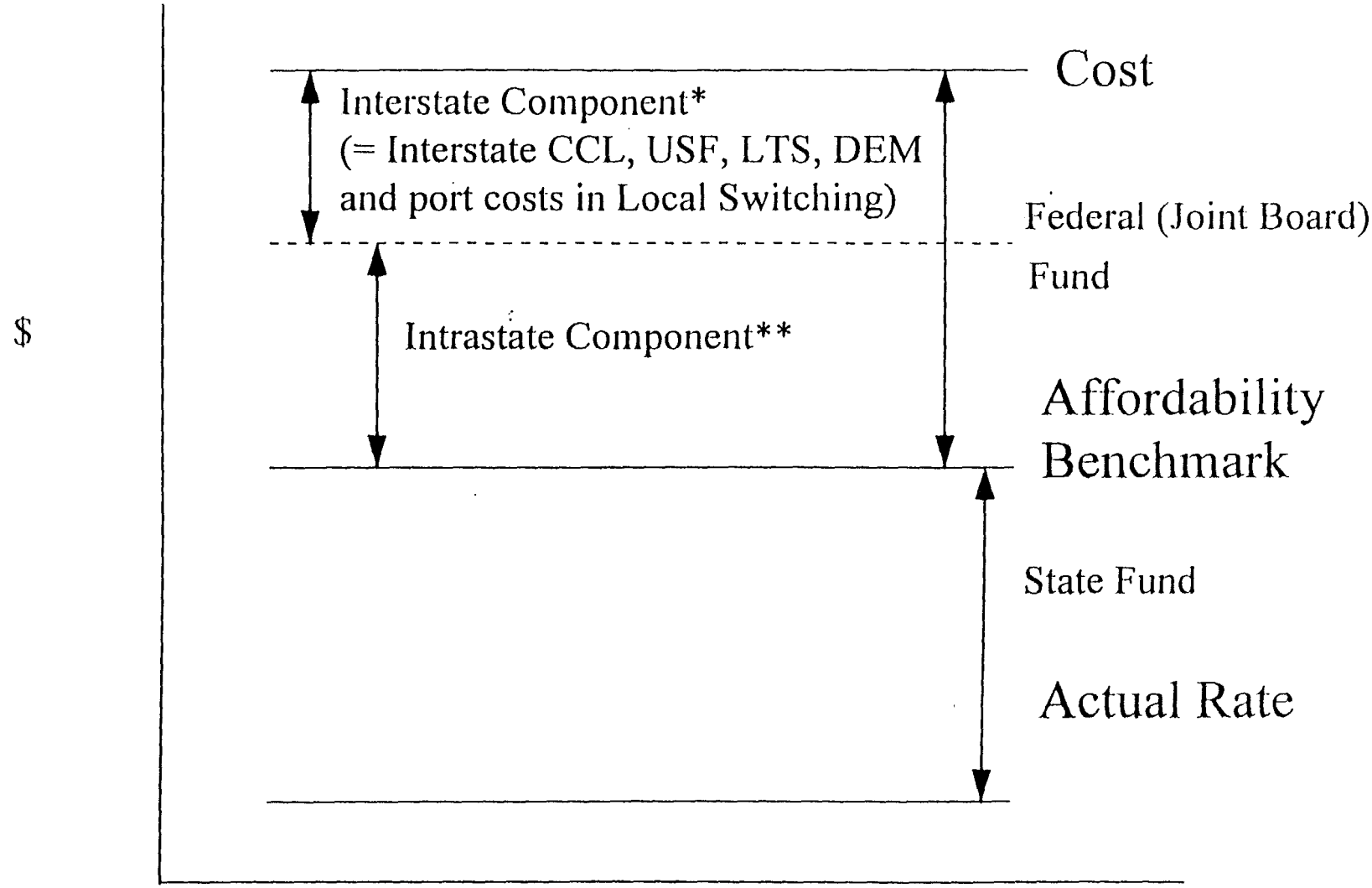
Core Universal Service Support - Other issues

- BellSouth proposes that support always go to the facilities based carrier when resale of local exchange service is involved
- State Commissions to determine serving areas
  - » Costs vary between rural and urban areas
  - » Serving areas should reflect cost differences
  - » BellSouth recommends wire centers for determining universal service support if book costs are used
- Auctions for universal service support are subject to considerable gaming and should not be used

Federal Fund Support Should Be Split Into Interstate and Intrastate Components

- Splitting the fund into interstate and intrastate components would avoid any jurisdictional shifts
- Interstate component would at least equal interstate CCL, USF, DEM weighting and Long-Term Support
- Intrastate component would equal total Federal support less interstate support
- Interstate retail revenues would be assessed to fund interstate component; intrastate retail revenues would be assessed for intrastate component

EXAMPLE OF JURISDICTIONALIZATION OF UNIVERSAL SERVICE PROPOSAL



* Funded via Interstate Retail Revenues

** Funded via Intrastate Retail Revenues

All Universal Service Support Should be Offset through Rate Reductions Upon Implementation

- Any net support initially received from the interstate component should be offset through interstate switched access rate reductions
- Any net support initially received from the intrastate component should be offset through intrastate rate reductions
- Implementation of Universal Service Support Mechanisms should be done in a revenue neutral manner (on Day 1 only)

Size of Federal Universal Service Fund

- Core federal universal service fund would depend on affordability benchmarks and cost standards
- The interstate component of the core fund would be in the range of $5-7 billion
- Core fund size could be decreased by up to $3 billion through SLC increases

Consider SLC Increases to Minimize Fund Size

- Interstate SLC has been $3.50 since 1989
- When SLC was implemented (late '80s), penetration levels increased
- Any increase in the SLC would be offset by a decrease in access charges
- IXCs should have obligation to flow through access charge reductions
- A modest gradual SLC increase would not affect affordability
- LifeLine assistance should be increased to match any increase in the SLC, thereby reducing overall expenditures for the low-income
- Rate rebalancing is part of the transition to a competitive environment

Advanced Services

- Basic telephone service line and modem allows access to the Internet and Advanced Services
- Deployment of Advanced services should not be mandated. The marketplace should be allowed to provide them in a timely and efficient manner
- Section 706 Notice of Inquiry
  - » FCC must initiate within 2 1/2 years from enactment of 1996 Act (by August 8, 1998)
  - » NOI must be completed within 6 months

The Four Cost Proxy Models Under Consideration

- The original Benchmark Cost Model (BCM)
  - » Sponsored by USWest, Sprint, MCI and NYNEX
  - » MCI used a low annual cost factor, while the other three endorsed a higher ARMIS-based annual cost factor
- The Benchmark Cost Model 2 (BCM2)
  - » Sponsored by USWest and Sprint
  - » Significant changes made to original BCM
- The Cost Proxy Model (CPM)
  - » Developed by Dr. Rick Emmerson (INDETEC) for Pacific Bell
- The Hatfield Model - Version 2.2
  - » Sponsored by AT&T and MCI

The Original BCM is Seriously Flawed and Should Not Be Used

- Criticized by numerous parties including BellSouth
- It overestimates costs in rural areas and underestimates costs in urban areas
- It leaves out drop wire and terminal expense
- All expenses calculated based on a ratio to investment
- Census block groups sometimes assigned to wrong wire centers